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RUCNASE/ASEAN MEMBER COLLECTIVE
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SUBJECT: FINANCIAL CRISIS BEGINS TO TAKE TOLL ON REAL ECONOMY AND
GROWTH FORECAST REDUCED (AGAIN)

Ref: Jakarta 2140

¶1. (SBU) Summary: A sharp slowdown in export demand is beginning to take a toll on Indonesia's real economy, resulting in a growing number of layoffs and production cuts. Continued tight credit markets are posing an added burden on business and played a role in the government takeover and bailout of Bank Century. Coordinating Minister for Economic Affairs and Finance Minister Sri Mulyani Indrawati warned that 2009 economic growth could slow to 4.5%, despite fiscal stimulus. With the Indonesian rupiah remaining weak, Bank Indonesia provided further guidance on recently issued foreign exchange regulations, explicitly prohibiting the purchase of foreign exchange for the use of structured products aimed at return enhancement. Lingering questions about the Bakrie Group's attempted workout of debt issues continued to weigh on the equity market. End summary.

Growth Forecast Reduced As Export Demand Falls
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¶2. (U) With total exports down 11.61% from September to October (see septel) and a sharp downturn in orders for early 2009 from traditional export markets, Indonesia's "real economy" is beginning to experience the effects of the growing global economic slowdown. With the outlook for 2009 economic growth remaining poor, Coordinating Minister for Economic Affairs and Finance Minister Sri Mulyani Indrawati has warned that 2009 economic growth may slow to as low as 4.5%, substantially below the 6.2% rate the government continues to expect for 2008. (Note: The Finance Minister's latest estimate, made on December 2 to the House of Representatives, is for 2009 economic growth between 4.5 and 6 percent.) As reported reftel, many market analysts continue to forecast 2009 growth of 3 to 4 percent, although domestic analyst forecasts tend to be slightly higher.

Reports of Production Cuts and Layoffs Cause Alarm,
Prompting Calls for More Government Stimulus

13. (U) Firms are beginning to react to worsening global economic conditions by cutting production and laying off workers. The Ministry of Labor and Migration has said that, as of November 28, nearly 17,000 workers had already lost their jobs and about 6,600 had been laid off (year to date). Employers had already informed the Ministry that they are in the process of dismissing another 24,000 employees, and laying off an additional 19,000 employees. The job losses have been heaviest in the Jakarta area (over 14,000), but are spread throughout the country. While job cuts in the formal sector appear to have been relatively limited to date, many business associations and firms have said they have also trimmed their non-permanent, contract workforce. Firms also warned that they expect additional layoffs and dismissals as export orders dry up and they begin to cut production lines. The head of the Indonesian Employers Association, Sofyan Wanandi, has been quoted in the press as estimating as many as 500,000 to a million workers will lose their jobs by mid-2009. In addition, there have been several reports of planned investment projects that have been reduced, deferred or canceled, given the uncertainty of future demand.

14. (U) In a December 2 hearing before the House of Representatives, Sri Mulyani assured legislators the government was in the process of speeding up a fiscal stimulus package. In addition to plans to provide businesses with tax relief worth an estimated IDR 12.5 trillion in 2009, the government is trying to accelerate infrastructure spending aimed at maintaining domestic demand. Other government efforts to ease problems stemming from tight credit

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markets, including plans to provide additional trade finance, remain works in progress, with corresponding implementing regulations not yet in place.

Takeover of Bank Century Has Raised
Questions About BI Oversight

15. (SBU) The government's November 21 takeover of PT Bank Century Tbk has raised questions about the quality of Bank Indonesia oversight, as details behind Bank Century's liquidity difficulties emerged. Bank Century's capital asset ratio fell from over 14% at end-September to -2.3% in mid-November due to the default of risky, non-rated securities held by the bank. The bank's controlling shareholders also failed to provide additional needed capital, despite having reportedly guaranteed these risky securities with off-shore deposits. Although Bank Century attempted to negotiate a sale of its assets, uncertainty about the bank's stability prompted the government's decision to have LPS, the Indonesian Deposit Corporation, take over the bank. LPS has announced that it has already provided IDR 2.5 trillion (about \$208 million) in temporary additional capital to the bank, bringing its capital asset ratio to about 10 percent. Yet media reports through end-November detailed continued difficulties some depositors were experiencing in withdrawing deposits, particularly foreign currency deposits, from the bank.

16. (SBU) Indonesian authorities have arrested Bank Century's founder and a major shareholders, Robert Tantular, on suspicions of unduly influencing bank operations. The authorities also arrested the bank's former president-director for breach of banking regulations. BI has said it has sought the return of Bank Century assets reportedly held in the U.K. and Singapore. Authorities are also seeking return of bank funds from two other controlling shareholders, who are not Indonesian nationals. Meanwhile, analysts are predicting significant further consolidation in the banking sector as depositors move funds to larger, more stable financial institutions.

BI Clarifies Recent Foreign Exchange Regulations,
Reiterates Prohibition Against Speculative Activity

¶7. (SBU) In the wake of continued rupiah weakness, Bank Indonesia (BI) issued on November 28 additional guidance regarding its recent foreign exchange regulations. A circular letter reiterated the prohibition against the purchase of foreign exchange, in any amount, for speculative activities. BI specified that speculative activities included the use of structured products that combine assets and foreign exchange derivatives for the sole purpose of enhancing investment returns.

¶8. (SBU) A number of local market analysts welcomed moves aimed at tightening Indonesia's capital account, which they believe creates excessive vulnerability to short-term foreign exchange movements. However, BI Governor Boediono reiterated Indonesia's commitment to maintaining capital mobility in a statement on November 21. Few market analysts expect authorities to impose significant new capital controls.

Scrambling to Cover 2009 Budget Deficit - - - - -

¶9. (SBU) The government continues efforts to mobilize external financing to fund the 2009 budget deficit. The World Bank is preparing a policy package for its contingent Development Policy

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Loan (see reftel) and is continuing to engage in further discussions with the Asian Development Bank and Australia and Japan on co-financing. The Ministry of Finance is also proceeding with plans for a retail sukuk (Islamic bond) issuance for end-February. Plans for a global USD sukuk issuance, originally scheduled for late 2008, remain on hold given market conditions.

Bakrie Group: Lack of Transparency of New Debt Deals Continues to Weigh on Market - - - - -

¶10. (U) The November 28 announcement by Bakrie & Brothers ("BNBR") management that it had entered into two deals which would resolve Bakrie Group debt problems has not eased the negative sentiment surrounding the troubled Group. In a press release, BNBR announced it had reached agreement with Northstar Pacific to form a strategic partnership, transforming their previous sales and purchase agreement into a buyout arrangement to take over BNBR's collateralized assets from Oddickson Finance. Northstar and BNBR plan to establish a joint venture company, which would own these collateralized assets.

¶11. (SBU) While Northstar reportedly agreed to purchase \$575 million in Bakrie Group debt owed to Oddickson, the Financial Times has reported that U.S. private equity firm Texas Pacific Group (TPG) had withdrawn from the deal, putting into doubt Northstar's ability to fund a debt purchase of that size. Northstar management has denied TPG's withdrawal, but they have reportedly indicated its purchase of Bakrie Group debt may occur over time, with an initial purchase of perhaps \$150 million. Such a go-slow approach, if adopted, would suggest TPG is not willing to add additional capital beyond its original stake in the Northstar Pacific equity firm.

¶12. (U) On November 28, local private equity firm Ancora Capital Management also reportedly reached agreement to assume BNBR's remaining \$72 million debt to JP Morgan. Press reports differ about whether Ancora will receive the Bumi Resources shares that had secured the loan. BNBR's press release advised it had already settled most of its direct debt and would arrange to resolve the remaining debt of about \$200 million, including debt owed to India's ICICI Bank (\$101.5 million) and to other local firms (\$81.5 million) by year's end. Meanwhile, state-owned enterprise PT Tambang Batubara Bukit Asam announced that it would not participate in the Northstar deal.

¶13. (SBU) Market reaction to the announcements of these developments has been mixed, with observers complaining about the lack of information on the structure of the strategic partnership and the division of share ownership. Indonesia Stock Exchange management has requested BNBR to provide more information about its various

agreements.

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